GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2009 Biennium

Bill #	SB0494
Title:	Special capital gains tax rate on employee-owned Montana stock
Primary Sponsor:	Perry, Gary L
Status:	As Introduced

- ☐ Significant Local Gov Impact
- ☑ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☑ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Expenditures:				
General Fund	$45,616	$38,457	$39,270	$40,103
Revenue:				
General Fund	($174,831)	($349,662)	($349,662)	($349,662)
Net Impact-General Fund Balance	($220,447)	($388,119)	($388,932)	($389,765)

Description of fiscal impact:

This bill would essentially exempt from taxation capital gains on certain sales of stock in Montana corporations by current or former employees. This would reduce general fund revenue by about $350,000 per year on average.

FISCAL ANALYSIS

Assumptions:

1. This bill would allow taxpayers to elect to have capital gains on the sale of stock in an eligible Montana corporation taxed at a special rate of 2% if they acquired the stock as an employee or as compensation for employment by the corporation. To be eligible, a corporation must be headquartered in Montana, have at least 25 full-time employees residing in the state, have more than 50% of its officers residing in the state, have at least 30% of its employees in the state, and not be closely held by related persons. The election can continue to apply if the original taxpayer gives the stock to an immediate family member, either directly or through a trust. This bill would apply beginning with tax year 2007.
2. Taxpayers who elect to have capital gains taxed at the 2% rate will continue to receive the 2% capital gains credit in 15-30-183, MCA. In effect, capital gains affected by this bill will not be taxed.

3. Every year, there will be some current or former employees of eligible Montana corporations who sell shares of their employers' stock and elect to have the provisions of this bill apply. In addition, there will be occasional instances where the founders or other major stockholders of a successful business sell a significant number of shares with very large capital gains, as in an initial public offering.
4. The Department of Revenue conducted a study of 1995, 1998 and 2001 returns with capital gains and found that about 27% of gains were from sales of securities, which are primarily stocks but include bonds and some other financial instruments. Only a small fraction of stock sold by Montana taxpayers in a typical year will meet the requirements of this bill. This fiscal note assumes that, in each of the next four years, ½% of capital gains will be subject to the special treatment in this bill.
5. Capital gains are projected to be $1,554,054,359 each year (HJR 2).
6. Capital gains affected by this bill will be $7,770,272 (1/2% x $1,554,054,359) each year.
7. The average marginal tax rate on capital gains reported on 2005 full year resident tax returns was 6.5%. The capital gains credit is 2% for tax year 2007 and following years. Thus, the *effective* average marginal tax rate on capitals gain is 4.5%.
8. Under current law, the tax on capital gains that would be affected by this bill would be $349,662 each year (4.5% x $7,770,272). This bill would reduce tax liability by this amount, beginning in tax year 2007.
9. The revenue reductions due to this bill will show up when taxpayers file their returns for the tax year. Most taxpayers who would take advantage of this bill file extension returns in October. Taxpayers who file on extension must pay their expected tax by the normal filing deadline, but many receive refunds. Half of the revenue reductions for tax year 2007 will show up as lower payments in the spring of FY 2008 and half will show up as larger refunds in the fall of FY 2009. Thus, general fund revenue will be reduced by $174,831 in FY 2008 (1/2 x $349,662) and by $349,662 in following fiscal years.
10. In a year when an eligible corporation makes an initial public offering, capital gains affected by this bill could be as high as $100 million. The revenue loss in such a year would be $4.5 million (4.5% x $100 million).
11. The Department of Revenue would need to verify elections to have capital gains taxed under the provisions of this bill. The department would need an additional half FTE auditor beginning in FY 2008. Personal services costs would be $31,718 in FY 2008, increasing by 2.5% per year in subsequent years. Set up costs for furniture and office equipment would be $5,900 in FY 2008. Operating costs would be $7,998 in FY 2008, including $2,500 for developing a new form, and $5,946 in following years.

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Fiscal Impact:				
FTE	0.50	0.50	0.50	0.50
Expenditures:				
Personal Services	$31,718	$32,511	$33,324	$34,157
Operating Expenses	$7,998	$5,946	$5,946	$5,946
Equipment	$5,900	$0	$0	$0
TOTAL Expenditures	$45,616	$38,457	$39,270	$40,103
Funding of Expenditures:				
General Fund (01)	$45,616	$38,457	$39,270	$40,103
TOTAL Funding of Exp.	$45,616	$38,457	$39,270	$40,103
Revenues:				
General Fund (01)	($174,831)	($349,662)	($349,662)	($349,662)
TOTAL Revenues	($174,831)	($349,662)	($349,662)	($349,662)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($220,447)	($388,119)	($388,932)	($389,765)

Long-Range Impacts:

1. The revenue loss from this bill will vary from year to year, ranging from several hundred thousand dollars to several million dollars.

Technical Notes:

1. This bill allows taxpayers to elect to have certain capital gains subject to “a separate tax.” This fiscal note assumes that the tax is in lieu of the regular income tax rather than in addition to the regular income tax, but the bill is not clear on that point.
2. Section 1(2)(a) defines “corporation” for the purposes of this bill. One of the requirements relates to “the time of the first sale or exchange of capital stock for which an election has been made.” It is not clear whether this refers to the first time an election has been made by the taxpayer in question or the first time an election has been made with respect to the corporation by any taxpayer.
3. Section 1(2)(a)(i) requires that a corporation have more than 50% of its corporate officers residing in the state and at least 30% of its employees located within the state. It is not clear how these requirements are to be applied. Is it as of a particular date or continuously throughout a year? If it is continuously throughout a year, is it the taxpayer’s tax year, the company’s fiscal year or some other period. Who is to verify that a corporation meets the requirements?
4. In Section 1(2)(a)(iii), the phrase “at least 3 shareholders or a group of shareholders who are not related to each other and each of whom owns at least 10% of the capital stock” is not clear. Three shareholders are a group, so referring to both appears to be redundant.
5. Section 1(4) defines “predecessor or successor corporation.” This definition could be clarified by reference to appropriate sections of the Internal Revenue Code, including Sections 355, 356, and 368.
6. Section 2(1) refers to stock acquired “on account of employment by the corporation.” This phrase is not clear. It would appear to include stock acquired as part of an employee’s compensation and stock

acquired through an employee stock purchase program. It is not clear whether it would include stock acquired in other ways, such as a company making gifts of stock to former employees.

7. Section 2(2)(a) makes the election to have capital gains taxed as provided in this bill apply "in any tax year if the sale or exchange of capital stock is in the same corporation...). It is not clear whether "any tax year" means every tax year after the election is made or has some other meaning.

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*